**Unit 1.3 - Government Intervention**

*Per Unit Subsidies and Price Controls*

**Part 1 Subsidies**

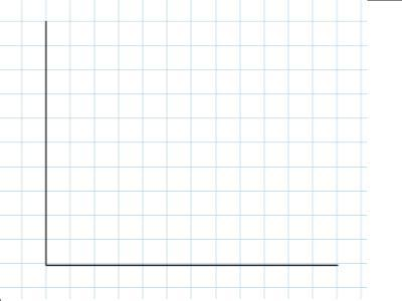
1. Define *per unit subsidy* and explain why a government may want to employ subsidies in the market for particular goods and services.

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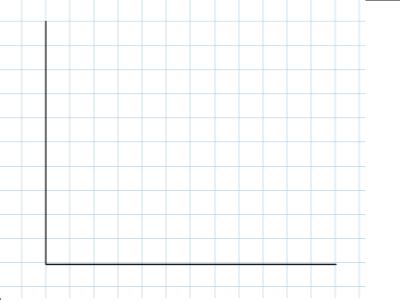
1. Explain the effect a per unit subsidy has on the market for a particular good.

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1. On the graph below, illustrate the market for raw milk in Switzerland in equilibrium, with no government intervention, assuming the demand for raw milk is relatively inelastic. Identify the following on the graph
   1. Consumer surplus:
   2. Producer surplus:
   3. Equilibrium price and quantity:



1. Next, illustrate the effect of a per unit subsidy in the market for raw milk in Switzerland.



1. Show and explain how each of the following has been affected as a result of the subsidy:
   1. The equilibrium price paid by consumers

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* 1. The price received by producers (this is the consumer price plus the per unit subsidy)

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* 1. The new level of consumer surplus

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* 1. The level of producer surplus

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* 1. The total cost of the subsidy to taxpayers

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1. Who benefits from the subsidy on milk in Switzerland? Who suffers?

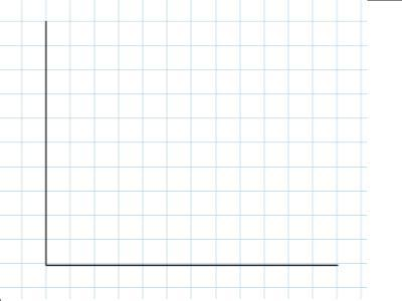
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1. Compare the total increases in consumer and producer surplus you identified with the area representing the total cost of the subsidy to taxpayers. Which area is greater? What does this say about the efficiency of the dairy subsidy in Switzerland?

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**Part 2 Price Controls**

1. Next consider the following: Instead of subsidizing Swiss dairy producers, the government instead imposes a minimum price on the market. Starting with the same graph you drew in #3 above, illustrate the effect of a minimum price (price floor) for milk in Switzerland set above the market equilibrium price.



1. Who is a price floor intended to help in the dairy market in Switzerland, producers of consumers. Explain.

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1. Illustrate on your graph and explain the effect that the price floor has on each of the following:
   1. The quantity of raw milk supplied in Switzerland:

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* 1. The quantity of raw milk demanded in Switzerland:

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* 1. Consumer surplus in the milk market:

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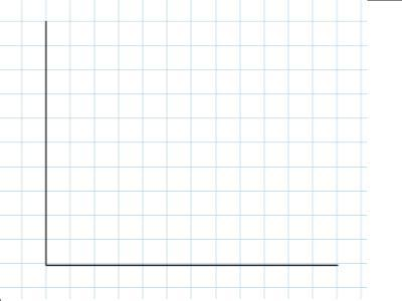
* 1. Producer surplus in the milk market:

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1. What impact does the price floor have on equilibrium in the market for milk in Switzerland? Is the price floor efficient? Why or why not? On your graph in #9, show the effect the price floor has on efficiency in the market (total welfare).

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1. Change of gears: Assume the city of Zurich imposes maximum rental rates on all new apartments constructed from 2012 onwards. Illustrate the market for apartment in Zurich with a government imposed maximum price (price ceiling) set below the equilibrium rental rate:



1. Who is the price ceiling intended to help, landlords or tenants? Explain.

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1. Illustrate on your graph in #13 and explain the effect that the price ceiling has on each of the following:
   1. The quantity of new apartments supplied in Zurich:

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* 1. The quantity of new apartments demanded in Zurich:

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* 1. Consumer surplus in the rental market:

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* 1. Producer surplus in the rental market:

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1. What impact does the price ceiling have on equilibrium in the market for apartments in Zurich? Is the policy of a maximum price efficient? Why or why not? On your graph in #13, show the effect the price ceiling has on efficiency (total welfare) in the Zurich rental market.

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